As petitioner is not protected in his operation as a common carrier by the proviso, we need not consider to what extent, if at all, the federal Motor Carrier Act superseded the state Motor Truck Law, or any other question presented by petitioner.

Affirmed.

M. E. BLATT CO. v. UNITED STATES.

CERTIORARI TO THE COURT OF CLAIMS.

No. 98. Argued November 15, 16, 1938.—Decided December 5, 1938.

1. Special findings of fact made by the Court of Claims are not affected by any statement of fact, reasoning, or conclusion that may be found in its opinion. P. 277.
2. Rent is a fixed sum, or property amounting to a fixed sum. It does not include payments, uncertain as to amount and time, made by the lessee for the cost of improvements. P. 277.
3. Improvements made by the lessee, even when required by the lease, will not be deemed rent unless such intention is plainly disclosed. *Id.*
4. Improved real property was leased for use as a picture theater, for ten years beginning upon completion of improvements made and paid for partly by the lessor and partly by the lessee. The lease provided that improvements made by the lessee should become the property of the lessor, on expiration or earlier termination of the leasehold. The Commissioner of Internal Revenue estimated the depreciated values, at the end of ten years, of the lessee's improvements, omitting some which could then have no value, and added one-tenth of the total estimate to the lessor's income for the tax year next following the commencement of the lease. *Held* erroneous.

   (1) The question presented is whether, under this particular lease, one-tenth of this "estimated depreciated value," at the end of the term, was income of the lessor in the first year of the term. There is nothing in the findings to suggest that cost of any improvement made by lessee was rent or an expenditure not properly to be attributed to its capital or maintenance account as distinguished from operating expense. They disclose no basis of value on which to lay an income tax or the time of realization of taxable

gain, if any there was. The figures made by the Commissioner are not defined. The findings do not show whether they are intended to represent value of improvements if removed or the amount attributable to them as a part of the building. The figures themselves repel the suggestion that they were intended to represent amounts obtainable for the items if removed; it is not to be assumed that they were intended as valuations of salvage at the end of the term; and it does not appear that the improvements, if detached, would then have any value, even as junk, over necessary cost of removal. Equally conjectural would be assumption that the figures represent enhancement of value of the leased premises by reason of the improvements when new, or as deteriorated at the end of the term. Present or future value of the premises, however ascertained, is single in substance; it can not be arrived at by mere summation of actual or estimated cost of constituent elements, new or depreciated. Pp. 276, *et seq.*

(2) Granting that the improvements increased the value of the building, the enhancement was not realized income of lessor; it was addition to capital, not income within the meaning of the Revenue Act of 1932, § 22 (a). P. 279.

(3) Assuming that at sometime value of the improvements would be income of lessor, it can not be reasonably assigned to the year in which they were installed. P. 280.

87 Ct. Cls. 413; 23 F. Supp. 461, reversed.

CERTIORARI, *post*, p. 581, to review a judgment rejecting a claim for recovery of money paid as an additional income tax.

Mr. Lawrence Cake for petitioner.

When improvements are made by a lessee, as in this case, there is no realization of gain by the lessor at the time when the improvements are completed.

The tenant agreed to paint and decorate (provided the landlord would pay $1500 of the cost) and to install the latest type of moving picture and talking apparatus, theatre seats, and all other fixtures, furniture, and equipment necessary for the successful operation of a modern up-to-date theatre. That was all. The tenant was not required to spend any certain amount. The amount was left entirely to his discretion and self-interest. He had a lease for ten years and presumably would spend as much on improvements as would fit the premises for his purpose, but he was not required to spend any amount whatever for the benefit of the lessor. So far as the lease went, his expenditures might well be limited to improvements which would have a life not exceeding the term of the lease. If he spent more and the improvements he made were of such character as would carry over some residual value beyond the term of the lease, any such excess value would be a gift to the lessor. At all events it was not required by the terms of the lease.

The common definition of rent or rental is an agreed fixed payment for the use of property. It need not necessarily be payable in money but it must be agreed upon and it must be fixed in amount or quantity. *Duffy* v. *Central Railroad Co.,* 268 U. S. 55, 63.

It is the fundamental rule of income taxation, laid down in *Eisner* v. *Macomber,* 252 U. S. 189, that to constitute taxable gain or income there must be a realization, either by severance from the source or by conversion of both source and gain into a different form, and that unrealized appreciation in value is not taxable as income. *United States* v. *Safety Car Heating & L. Co.,* 297 U. S. 88, 99. Compare also *Koshland* v. *Helvering,* 298 U. S. 441; *North American Oil Consolidated* v. *Burnet,* 286 U. S. 417; *MacLaughlin* v. *Alliance Insurance Co.,* 286 U. S. 244; *Burnet* v. *Logan,* 283 U. S. 404.

Here the petitioner is the owner of property which it has leased to another for ten years. The lessee of the property has added improvements which the Commissioner has found will have a residual value of $17,423.14 at the end of the term of the lease. The value of petitioner's property, therefore, has been increased and a part of that increased value will presumably still be in the property when it reverts to petitioner upon the termination of the lease. Has petitioner realized any immediate gain by virtue of all this? Certainly there has been nothing "severed" from the property (petitioner's capital) or "received or drawn" by petitioner for its "separate use, benefit and disposal." There has been no gain or profit in the sense of "something of exchangeable value proceeding from the property." Petitioner has no control over the property, or the improvements, so long as the lease runs. Even when the lease ends, petitioner will have only the possession of real estate bearing improvements which fit it for use as a theatre.

The court below suggests, however, that petitioner has at all times a right to sell the property subject to the lease, and so immediately realize the cash value of the improvements to the extent that they will have value beyond the term of the lease. This does not aid the court's conclusion. On the contrary, it supports petitioner's argument that there was no realization of gain at the time the improvements were added, and that the realization of gain, if any,—and the taxation thereof as income—can only take place upon the sale or other disposition of the property. *Hewitt Realty Co.* v. *Commissioner*, 76 F. 2d 880.

The decision of the court below ignores the practical difficulties and realities of the situation.

It seems fairly obvious that the regulations in question which tax as income to the lessor, either immediately or by spreading it over the term of the lease, the "estimated depreciated value" at the end of the lease of any improvements made by the lessee, are bound to be uncertain and difficult of application in particular cases. See Morphy v. Commissioner, 35 B. T. A. 289, minority opinion; Hart v. Commissioner, 37 B. T. A. 360; Paul & Mertens, Law of Federal Income Taxation, Vol. 1, § 10.12, 1937 Supplement.

If the "income" which the Government has charged to petitioner here, not only for the taxable year actually involved in this case but likewise for every year of the lease in question, is in fact and in law income to petitioner as the Government contends, it becomes a problem to determine how it can be distributed so as to avoid the tax on undistributed profits.

When improvements are made by a lessee, as in this case, the accession of value to the property is not income but a capital addition. *Edwards* v. *Cuba Railroad Co.,* 268 U. S. 628. See *Taft* v. *Bowers,* 278 U. S. 470.

Mr. J. Louis Monarch, with whom *Solicitor General Jackson* and *Assistant Attorney General Morris* were on the brief, for the United States.

(a) The view that the income is realized upon completion of the improvement.—The legal significance of adding improvements to the lessor's property is precisely equivalent to the payment of advance rentals, and therefore the income is realized when the improvements are complete. The lessor is undoubtedly the owner as soon as the improvements are made, and if title be the test he has then derived income. The cash rentals are allocable in part to the improvements, so that the lessor has the immediate use of the improvement to that extent, just as he has the use and benefit of the rest of the property. The only reason why he is not entirely free to use the property is that he has agreed in advance with the lessee to permit the latter the exclusive use. This circumstance is analogous to the assigned income cases and should not prevent the tax. Moreover, the concept of income does not necessarily require that the respondent have the unrestricted right to enjoy it. *Burnet* v. *Harmel,* 287 U. S. 103; *Poe* v. *Seaborn,* 282 U. S. 101; *Miller* v. *Gearin,* 258 F. 225; 250 U. S. 667; *Cryan* v. *Wardell,* 263 F. 248.

The Treasury Regulations then in effect provided that the depreciated value of improvements erected by a lessee constituted taxable income to the lessor upon the termination of the lease. Art. 4, par. 50, Reg. 33 (Rev. ed.); Art. 48, Reg. 45. But the cited cases overruled the existing regulations, whereupon the Treasury made changes to conform to the decisions. T. D. 3062, 3 Cumulative Bulletin 109; Mim. 2714, 4 Cumulative Bulletin 90; Art. 48, Regulations 45 (1920 ed.). The Regulations under the later Acts have consistently regarded the income as realized upon the completion of the improvements. The Regulations under the 1921 and subsequent Acts have permitted the gain to be spread over the life of the lease. Art. 48, Regulations 62, 65 and 69; Art. 63, Regulations 74 and 77; Art. 22 (a)–13, Regulations 86 and 94.

Against this view it may be urged that the lessor has not "derived" the income because he is not free to use it. But the lessor derives rent from the improvements and, to that extent at least, it would appear that he does use the improved property. His full right of use is tied up and restricted during the term of the lease by the agreement of the parties made in advance of the improvements. In other situations it has been held that such an assignment does not avoid the tax. *Lucas* v. *Earl,* 281 U. S. 111; *Lonsdale* v. *Commissioner,* 32 F. 2d 537; 280 U. S. 575. Cf. *Burnet* v. *Wells,* 289 U. S. 670; *Poe* v. *Seaborn,* 282 U. S. 101; *Cleveland Ry. Co.* v. *Lucas,* 36 F. 2d 347; 281 U. S. 743; *Old Colony Trust Co.* v. *Commissioner,* 279 U. S. 716; *United States* v. *Hendler,* 303 U. S. 564; and see *United States* v. *Boston & M. R. Co.,* 279 U. S. 732.

(b) The view that the income is realized upon the termination of the lease.—If the restrictions upon enjoyment prevent the income from being treated as derived when the improvements are made, it should follow that the income is received when the restrictions are removed. The principle is well recognized that the release of a liability is the equivalent of receipt, and where income is physically received at a time when there is some restriction upon its use, the time of receipt is deemed to be postponed until the restriction is removed. If that theory is applicable, the income is derived at the expiration or earlier termination of the lease. *Helvering* v. *Mountain Producers Corp.*, 303 U. S. 376; *United States* v. *Kirby Lumber Co.*, 284 U. S. 1; *Helvering* v. *American Chicle Co.*, 291 U. S. 426; *Maryland Casualty Co.* v. *United States*, 251 U. S. 342; *North American Oil* v. *Burnet*, 286 U. S. 417, 424; cf. *Helvering* v. *Tex-Penn Co.*, 300 U. S. 481.

(c) The view that the income is realized upon disposition of the improved property.—The theory that the income is realized upon the disposition of the property is based upon the view that the increased value which resulted from the improvements is merely appreciation of some character, like an increase resulting from fluctuating conditions. However, there is little similarity between general conditions causing day-to-day fluctuations and a permanent improvement to the particular realty. Furthermore, this theory is based upon the misconception that there must be an actual physical separation of income from capital. We think the cases show that the concept of income is satisfied where the taxpayer's investment produces new property which, in some form, is made available to him. The simplicity of the theory has appealed to some courts, but if the income is lost as a result of unrelated events occurring between the time of its receipt and the disposition of the property, this theory would permit it to escape taxation altogether. In no other situation is a taxpayer excused from accounting for income because of its subsequent loss. *Hewitt Realty Co.* v. *Commissioner*, 76 F. 2d 880; *Marr* v. *United States*, 268 U. S. 536, 540; *Helvering* v. *Midland Ins. Co.*, 300 U. S. 216, 225; *Koshland* v. *Helvering*, 298 U. S. 441.

The case is squarely within the Regulations, and the validity of the tax depends upon the acceptance of the theory which underlies the Regulations.

MR. JUSTICE BUTLER delivered the opinion of the Court.

Petitioner paid, and in this suit seeks to recover, an amount included in a deficiency assessment made by the Commissioner of Internal Revenue as additional income tax for the year ending January 31, 1932. The question is whether petitioner is liable under Revenue Act of 1932, § 22 (a).[1]

The material substance of the findings follows.

For itself and a subsidiary corporation, petitioner made consolidated return. The commissioner added to the income of the subsidiary on account of improvements made to its property by a lessee. He ruled the improvements were income to lessor in that year to the extent of their value at termination of the lease.

Lessor purchased the real estate in 1927, and September 13, 1930, leased it for use as a moving picture theater for a term of ten years, beginning upon completion of improvements to be made. At its own cost and expense, lessor agreed to make alterations in accordance with plans and specifications prepared by an architect selected by the parties. Lessee agreed to install the latest type of moving picture and talking apparatus, theater seats and all other fixtures, furniture and equipment necessary for the

[1] "'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. . . ." 47 Stat. 178. The regulation applied by the commissioner (Reg. 77, Art. 63) has since been changed. See Reg. 94 and 86, Art. 22 (a)-13.

successful operation of a modern theater to become the property of lessor at the expiration or sooner termination of the lease.

Lessor made a contract with the builder to make the contemplated improvements and agreed to pay, up to a specified limit, actual cost, plus builder's profit and architect's fee. Additional work ordered by lessee was to be paid for by it. Lessee consented to the terms of the contract and agreed to pay for work and materials ordered by it. All improvements were completed in January 1931; lessee took possession of the property February 1 of that year.

The total cost of all improvements was $114,468.77; lessor paid $73,794.47; lessee paid the balance, $40,674.30. "The estimated depreciated value at the termination of the lease of the alterations and improvements paid for by the lessee was computed by the Commissioner and was agreed to by the plaintiff [petitioner], as follows:

	Cost	*Depreciated value at end of 10 years*
[1] Ventilating system	$3,959.75	$2,771.83
[2] Glazing, architect's fee and other items	10,366.37	7,256.46
[3] Painting	760.80	0
[4] Other improvements	185.97	0
[5] Chairs	9,167.24	3,055.75
[6] Booth	5,197.39	0
[7] Draperies	7,075.42	2,358.47
[8] Electric signs and marquee	3,961.36	1,980.63
Total	$40,674.30	$17,423.14"

From these figures it appears that the calculations were based on annual depreciation of items [1] and [2] at 3 per cent., on [5] and [7], at 6⅔ per cent., on [8], at 5 per cent., and on [3], [4], and [6], at 10 per cent.

For the year in question, the Commissioner added to income of lessor $1,742.31, one-tenth of the cost so depreciated. The resulting additional tax was $211.61. Petitioner paid it; the commissioner disallowed claim for refund. The lower court held petitioner not entitled to recover; it sustained the tax on the ground that, immediately upon completion of the improvements made by lessee, they became the property of lessor, and constituted compensation paid by lessee as additional rental for the use of the leased premises.

Petitioner insists that where improvements are made by lessee, there is no realization of gain at the time the improvements are completed; that the accession of value to the property is not income but a capital addition. The United States says that, while the case presents the question whether depreciated value of improvements by lessee constitutes income to lessor in the taxable year, the "basic question is whether income is ever realized by the lessor in such cases, and if so, when." Assuming that improvements made by lessee and which will outlast the term constitute income to lessor at some time, its brief discusses the questions whether the income is realized upon (1) completion of the improvements, (2) termination of the lease, or (3) disposition of the improved property. It concludes that the "soundest theory seems to be that such income is taxable at the time the improvements are erected." And, without supporting the lower court's ruling that the estimated depreciated value at the end of the ten-year term constituted additional rent or compensation paid for the use of the premises, it asks that the judgment be upheld.

We are not called on to decide whether under any lease or in any circumstances, income is received by lessor by reason of improvements made by lessee, nor to choose, for general approval or condemnation, any of the theories expounded by the United States. Concretely, the question presented is whether, under the lease here involved, one-tenth of what the commissioner and taxpayer call and agree to be "estimated depreciated value," as of the end of the term, was income to petitioner in the first year of the term. And that question is to be decided upon the lower court's special findings unaffected by any statement of fact, reasoning, or conclusion that may be found in its opinion.[2]

There is nothing in the findings to suggest that cost of any improvement made by lessee was rent or an expenditure not properly to be attributed to its capital or maintenance account as distinguished from operating expense. While the lease required it to make improvements necessary for successful operation, no item was specified, nor the time or amount of any expenditure. The requirement was one making for success of the business to be done on the leased premises. It well may have been deemed by lessor essential or appropriate to secure payment of the rent stipulated in the lease. Even when required, improvements by lessee will not be deemed rent unless intention that they shall be is plainly disclosed. Rent is "a fixed sum, or property amounting to a fixed sum, to be paid at stated times for the use of property . . .; . . . it does not include payments, uncertain both as to amount and time, made for the cost of improvements . . ."[3] The facts found are clearly not sufficient to sustain the

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[2] *Stone* v. *United States,* 164 U. S. 380, 383. *Crocker* v. *United States,* 240 U. S. 74, 78. *Brothers* v. *United States,* 250 U. S. 88, 93. *United States* v. *Wells,* 283 U. S. 102, 120. *United States* v. *Esnault-Pelterie,* 299 U. S. 201, 206. And see *American Propeller Co.* v. *United States,* 300 U. S. 475, 479–480.

[3] *Duffy* v. *Central Railroad Co.,* 268 U. S. 55, 63. *Dodge* v. *Hogan,* 19 R. I. 4, 11; 31 A. 269, 1059. *Guild* v. *Sampson,* 232 Mass. 509, 513; 122 N. E. 712. *Garner* v. *Hannah,* 6 Duer 262, 266. *Board of Comm'rs* v. *Pure Oil Co.,* 167 La. 801, 811; 120 So. 373. 2 Blackstone, p. 41.

lower court's holding to the effect that the making of improvements by lessee was payment of rent.

It remains to be considered whether the amount in question represented taxable income, other than rent, in the first year of the term.

The findings fail to disclose any basis of value on which to lay an income tax or the time of realization of taxable gain, if any there was. The figures made by the commissioner are not defined. The findings do not show whether they are intended to represent value of improvements if removed or the amount attributable to them as a part of the building.

The figures themselves repel the suggestion that they were intended to represent amounts obtainable for the items if removed. We are not required to assume that the commissioner intended his estimates to represent salvage, at the end of the term, of ventilating system, glazing, architect's fees and the like, draperies, chairs, electric signs, and marquee, the useful lives of which in place have declined from 30 to 66⅔ per cent. It does not appear that if detached from the building they would then have any value, even as junk, over necessary cost of removal. It is clear that, if any value as of that time may be attributed to them, it is included in and not separable from that of the leased premises.

Equally conjectural would be assumption that the figures represent enhancement of value of the leased premises by reason of the improvements when new or as deteriorated at the end of the term. The leased property is capable of inventory and analysis for the purpose of ascertaining original and estimated present costs of its elements and other relevant facts as indications of worth to be taken into account in determining its value; i. e., the money equivalent of the property as a whole.[4] But

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[4] *West* v. *Chesapeake & Potomac Tel. Co.*, 295 U. S. 662, 671. *Olson* v. *United States*, 292 U. S. 246, 255. *Standard Oil Co.* v. *Southern Pacific Co.*, 268 U. S. 146, 155.

present or future value, however ascertained, is single in substance; it cannot be arrived at by mere summation of actual or estimated cost of constituent elements, new or depreciated.[5] The addition to value of the leased premises resulting from the lessee's improvements may not be arrived at by formula or arithmetically by merely setting against each item or element its cost less depreciation estimated to accrue during the term of the lease.[6] The amount included in the total value of the structure reasonably to be attributed to the improvements after use for ten years is not ascertainable by the simple calculations employed by the commissioner.

Granting that the improvements increased the value of the building, that enhancement is not realized income of lessor.[7] So far as concerns taxable income, the value of the improvements is not distinguishable from excess, if any there may be, of value over cost of improvements made by lessor. Each was an addition to capital; not income within the meaning of the statute.[8] Treasury Regulations can add nothing to income as defined by Congress.[9]

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[5] *Denver Stock Yard Co.* v. *United States,* 304 U. S. 470, 479.

[6] *Minnesota Rate Cases,* 230 U. S. 352, 434. *Bluefield Co.* v. *Public Service Comm'n,* 262 U. S. 679, 690. *Standard Oil Co.* v. *Southern Pacific Co.,* 268 U. S. 146, 157, 159. *McCardle* v. *Indianapolis Water Co.,* 272 U. S. 400, 416.

[7] *Hewitt Realty Co.* v. *Commissioner* (CCA 2), 76 F. 2d 880, 884. *Eisner* v. *Macomber,* 252 U. S. 189, 207. *Lucas* v. *Alexander,* 279 U. S. 573, 577. Cf. *Bowers* v. *Kerbaugh-Empire Co,* 271 U. S. 170, 175.

[8] *United States* v. *Phellis,* 257 U. S. 156, 169, 175. *Merchants' Loan & T. Co.* v. *Smietanka,* 255 U. S. 509, 519–520. *Taft* v. *Bowers,* 278 U. S. 470, 480, *et seq.* *Lucas* v. *American Code Co.,* 280 U. S. 445, 449. *Eckert* v. *Burnet,* 283 U. S. 140, 142. *Burnet* v. *Logan,* 283 U. S. 404, 412–413. *United States* v. *Safety Car Heating Co.,* 297 U. S. 88, 99. *Koshland* v. *Helvering,* 298 U. S. 441, 444–445. Cf. *Commissioner* v. *Van Vorst* (CCA 9), 59 F. 2d 677, 680.

[9] *Koshland* v. *Helvering,* 298 U. S. 441, 447.

But, assuming that at some time value of the improvements would be income of lessor, it cannot be reasonably assigned to the year in which they were installed. The commissioner found that at the end of the term some would be worthless and excluded them. He also excluded depreciation of other items. These exclusions imply that elements which will not outlast lessee's right to use are not at any time income of lessor. The inclusion of the remaining value is to hold that petitioner's right to have them as a part of the building at expiration of lease constitutes income in the first year of the term in an amount equal to their estimated value at the end of the term without any deduction to obtain present worth as of date of installation. It may be assumed that, subject to the lease, lessor became owner of the improvements at the time they were made. But it had no right to use or dispose of them during the term. Mere acquisition of that sort did not amount to contemporaneous realization of gain within the meaning of the statute.

Reversed.

MR. JUSTICE STONE.

I acquiesce in that part of the Court's opinion which construes the findings below as failing to establish that the lessee's improvements resulted in an increase in market value of the lessor's land in the taxable year. As it is unnecessary to decide whether such increase, if established, would constitute taxable income of the lessor, I do not join in so much of the opinion as, upon an assumption contrary to the findings, undertakes to discuss that question.